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CITATIONS

675194—45

In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 573

ESTATE OF HUMPHREY J. LYNCH, DECEASED, THE COUNTY TRUST COMPANY AND MARY A. FLEMING, EXECUTORS, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 14–16) is not officially reported. The opinion of the Circuit Court of Appeals (R. 35–40) and the dissenting opinion (R. 40–42) are reported in 150 F. 2d 747.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on August 7, 1945 (R. 42). The petition for a writ of certiorari was filed on October 31, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, under Section 42 of the Revenue Act of 1938, legal fees earned in 1931 and never reported as income by the decedent who was on the cash basis of accounting, were properly includible as income in the return filed on behalf of the decedent's estate for the period January 1 to January 24, 1938, the date of his death, when, in 1931, the decedent had accepted from his clients a partial assignment, in an amount equal to his fee, of a Surrogate's Court's award to them out of an estate whose assets were held pending further order of the court and as to which appeals were pending at the time of the assignment, and when the decedent received nothing under this assigned claim before his death.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791:

Sec. 22. Gross income.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; * * *

* * * * *

Section 22 (a) of the Revenue Act of 1938, c. 289, 52 Stat. 447, is identical with the above-quoted provision. Revenue Act of 1938, c. 289, 52 Stat. 447:

Sec. 41. General rule.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; * * *

Sec. 42. Period in which items of gross income included.

The amount of all items of gross income shall be included in the gross income for

> the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. In the case of the death of a taxpayer there shall be included in computing net income for the taxable period in which falls the date of his death, amounts accrued up to the date of his death if not otherwise properly includible in respect of such period or a prior period.

Treasury Regulations 74, promulgated under the Revenue Act of 1938:

> ART. 53. *Compensation paid other than in cash.*—Where services are paid for with something other than money, the fair market value of the thing taken in payment is the amount to be included as income. If the services were rendered at a stipulated price, in the absence of evidence to the contrary such price will be presumed to be the fair value of the compensation received.

STATEMENT

The facts found by the Tax Court are as follows: The decedent, Humphrey J. Lynch, a lawyer residing at White Plains, Westchester County, New York, died on January 24, 1938. Mary A. Fleming, executrix under his will, filed with the Collector of Internal Revenue for the Fourteenth District of New York an individual income tax return for the decedent's estate for the calendar year 1938, ending on January 24th of that year.

The return was on the cash receipts and disbursements basis, which basis had been used by the decedent at all times prior to his death. (R. 11.)

During 1931, the decedent, as legal counsel for Marguerite H. Lynch, Elizabeth F. Lynch, and Anna L. Lynch, had prosecuted claims in their behalf against the estate of John H. McArdle, deceased, in the Surrogate's Court of Westchester County, New York. On October 30, 1931, decedent succeeded in obtaining for them, from the Surrogate, a decree of settlement allowing claims totaling $56,160. Interest on the claims and some other claims which had been made were disallowed. (R. 12.)

On November 16, 1931, Freda Rosenblum, an attorney employed by the decedent, wrote and mailed a letter to the Lynch sisters informing them that an assignment in the amount of $7,000 of the money due them by virtue of the decree against the McArdle estate would be acceptable by the decedent in payment of his fee and it was stated that $5,000 was for services already rendered while the remaining $2,000 was to be compensation for work connected with an appeal which the decedent intended to file on behalf of his clients from the disallowance of interest and other claims by the Surrogate. The assignment, which was noninterest-bearing, was executed by the Lynch sisters on November 18, 1931. (R. 12.)

The decedent, for his clients, the Lynch sisters, on November 30, 1931, filed in the Surrogate's

Court a notice of appeal from that portion of the decree of October 30, 1931, which disallowed the interest and other additional claims against the estate of McArdle. In addition, on December 1, 1931, Mary E. Roche and Helen Abbey, devisees under the will of McArdle, filed notice of appeal in the Surrogate's Court of Westchester County from the Surrogate's decree of October 30, 1931, allowing the claims of the Lynch sisters. Both of these notices of appeal were ultimately withdrawn. (R. 12.)

In the decree of October 30, 1931, the Surrogate's Court found the value of the assets of the McArdle estate, based on an appraisal made at or about the time of McArdle's death, January, 1938, to be $400,920.10 and the liabilities of the estate including the claims established by the decree to be $139,780. In that decree the Surrogate ordered that the various assets of the estate be held subject to the further order of the court. Complete distribution of the estate and payment of the Lynch claims did not take place until 1940, or approximately two years after the death of the decedent. The delay in distribution and payment of claims was occasioned by a conflict among several of the claimants for priority in distribution; by the assertion of further claims against the estate based on assessments against National Bank stock, formerly an asset of the estate; and by the fact that the assets of the estate were not in a liquid

condition but were invested in real estate and securities. (R. 13.)

The decedent did not report the receipt of the assignment as income in his tax return for the calendar year 1931 or for any subsequent year (R. 13).

The Commissioner determined that the sum of $5,000 earned by decedent in 1931, at which time he accepted from his clients a partial assignment of a claim which remained unpaid at the date of death and which was never reported by decedent who was on a cash receipts basis of accounting, was includible as income for the period ending with decedent's death (R. 13). The Tax Court (R. 16) and the Circuit Court of Appeals (R. 40) sustained the Commissioner's determination.

ARGUMENT

There is no conflict of decisions and none is pointed out by the taxpayers.

The decedent, who died on January 24, 1938, had never reported any amount as income as the result of the assignment to him, in 1931, of a portion of the Surrogate's award to his clients, the Lynch sisters. The distribution of $5,000 to his estate in 1940 was the first payment made on account of this assignment.[1] The court below affirmed the Tax Court's holding that under Section 42 of the Revenue Act of 1938, *supra,* the

[1] No claim is made that decedent was entitled to report income on any basis other than the cash basis.

amount was required to be included in the return for the taxable period in which fell the decedent's death as an amount "accrued up to the date of his death if not otherwise properly includible in * * * a prior period." [2]

The taxpayers' only contention is that the amount was properly includible in decedent's return for 1931 or in the alternative in his return for 1935. In rejecting these contentions the court below correctly applied the principle embodied in *North American Oil* v. *Burnet*, 286 U. S. 417. In that case, a receiver held impounded property pending litigation between the United States and the North American Oil Company as to its beneficial ownership. Income earned from the property in 1916 was turned over to the company in 1917 upon entry of a final decree in the district court dismissing the bill of the United States. The appellate phases of the litigation were finally terminated in 1922. The question was whether the income should have been reported by the company in 1916, 1917 or 1922. The company's first contention was that the income was returnable in 1916 when earned. This Court held that the company was not required to report in 1916 as income an amount which it had not yet received

[2] The term "accrued" is construed in this statute "in furtherance of the intent of Congress to cover into income the assets of decedents, earned during their life and unreported as income, which on a cash return, would appear in the estate returns." *Helvering* v. *Enright*, 312 U. S. 636, 644–645.

and which it might never receive. There was held to be no constructive receipt of the profits in 1916 because at no time during the year was there a right in the company to demand that the receiver pay over the money and during that time it was uncertain who would be entitled to the profits. It was held to be taxable in 1917 because actually received under a claim of right, though an appeal was pending. It seems clear that had the moneys not actually been received in 1917, the amount would have been income in 1922 rather than 1917 because of the pendency of the appeal. See *United States* v. *Safety Car Heating Co.*, 297 U. S. 88.

In the instant case, the decree of the Surrogate's Court of October 30, 1931, ordered that the assets of the McArdle estate be held subject to the further order of the court.[3] On December 1, 1931, an appeal was filed from the decree which had allowed the claim of the Lynch sisters, the decedent having already filed an appeal from portions of the decree disallowing certain claims of the Lynch sisters. At no time during the year 1931 was there a receipt of the sum or a right, either in the Lynch sisters or in the decedent, to demand that the court make any payment to anyone.

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[3] Delay in distribution was occasioned by conflicting claims of several claimants for priority in distribution, further claims against the estate based on assessments against National Bank stock, and the fact that assets were unliquid (R. 13).

There is no basis for the alternative contention that the claim became a legal right, that is, that it ceased to be a contingent claim, in 1935 and that the income was required to be reported for that year. This argument rests on the assumption that the appeals were withdrawn in 1935. But as observed by the court below (R. 39), there is no evidence as to when the appeals from the decree of the Surrogate's Court were withdrawn. The taxpayers had the burden of proof and on the basis of the record the Tax Court was not compelled to find that they were withdrawn in 1935 or any other period prior to the taxable period here involved.[4]

We submit that the lower court was correct in its application of *North American Oil* v. *Burnet, supra,* and *United States* v. *Safety Car Heating Co., supra,* to this case.

The court below concluded that the assignment should not be regarded or treated as property the receipt of which gives rise to the realization of income within the meaning of the income tax laws. In other words, the court held, such an assignment is not realized gain to the assignee for he

[4] Taxpayers' suggestion (Pet. 19) that the distribution of a dividend of .031141 ($1,839.50) to the Lynch sisters in 1935 is proof of withdrawal of the appeals is without merit. As the court below observed (R. 39) it is "speculation whether this small dividend was occasioned by the withdrawal of the appeals or to other circumstances of which we have no knowledge."

acquires no greater rights at the time of the assignment than those of his assignor.

Both the Tax Court and the court below pointed out the distinction between such property as negotiable notes, which are treated as income when received, and judgments which do not meet the fundamental concept of realized gain. This distinction has been adopted elsewhere and in other situations. *Kyle* v. *Commissioner,* 43 F. 2d 291 (C. C. A. 3d), certiorari denied, 282 U. S. 896. See also, *Shuster* v. *Helvering,* 121 F. 2d 643 (C. C. A. 2d), which points out the same distinction as to contracts.

The taxpayers' further argument that the decisions below are in contradiction of Article 53 of Treasury Regulations 74 (1928), *supra,* is without merit. As stated by the Tax Court (R. 15), the theory of Article 53 of Treasury Regulations 74 is that the taxpayer receiving in return for his services property having a fair market value, "has actually received as income something of value equivalent, to the extent of that value, to cash, which is just as includible in his income as cash would be." Although the opinion of the Tax Court is for the most part devoted to the absence of any evidence as to the fair market value of the assignment, it is obvious from the above quoted statement that the decision also rests on the theory that the assignment of a portion of the judgment was not something of value which was equivalent

to cash. That was but another way of saying that such an assignment is not property within the meaning of the income tax laws. *Helvering* v. *Enright*, 312 U. S. 636, which involved the question whether the income had accrued at the time of death, rather than the question whether the income should have been reported as realized income in any prior period, is not to the contrary.

CONCLUSION

The decision below is correct; there is no conflict and the case does not call for further review.

Respectfully submitted,

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